

Credit Analysis

Vietnam

Ratings

Foreign Currency	
Long-Term IDR	BB-
Short-Term IDR	B
Local Currency	
Long-Term IDR	BB-
Country Ceiling	BB-

Outlooks

Foreign-Currency Long-Term IDR	Stable
Local-Currency Long-Term IDR	Stable

Financial Data

Vietnam (USDbn)	2008
GDP	90.6
GDP per head (USD)	1,041
Population (m)	87.1
International reserves	24.2
Net external debt (% GDP)	-3.7
Central government total debt (% GDP)	36
CG foreign-currency debt	18.8
CG domestically issued debt (VNDtrn)	212.5

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Related Research

- [Country Ceilings \(September 2008\)](#)
- [Bank Systemic Risk Report \(May 2009\)](#)
- [Global Economic Outlook \(June 2009\)](#)
- [Guide to Sovereign Credit Report \(October 2008\)](#)
- [Sovereign Rating Methodology \(October 2007\)](#)

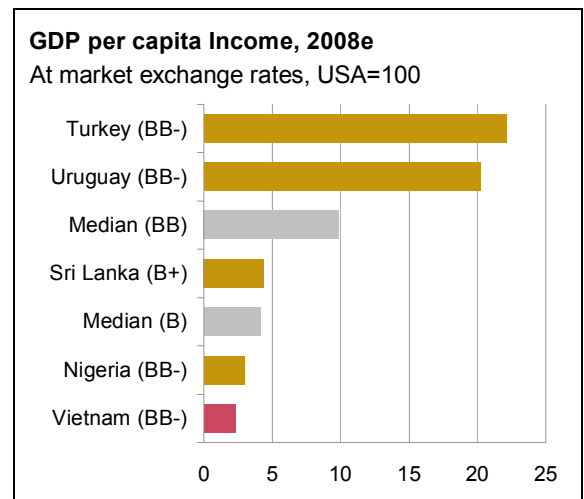
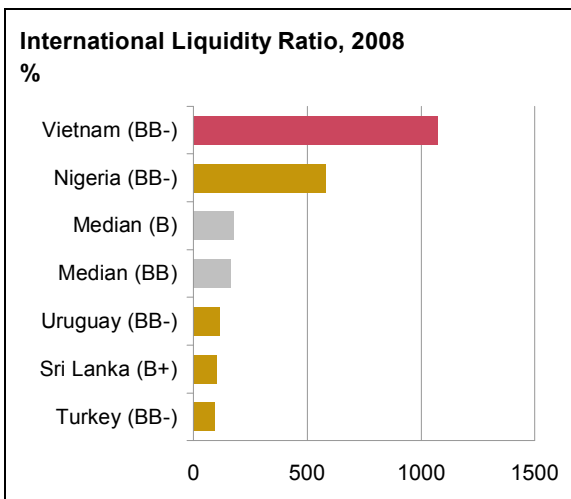
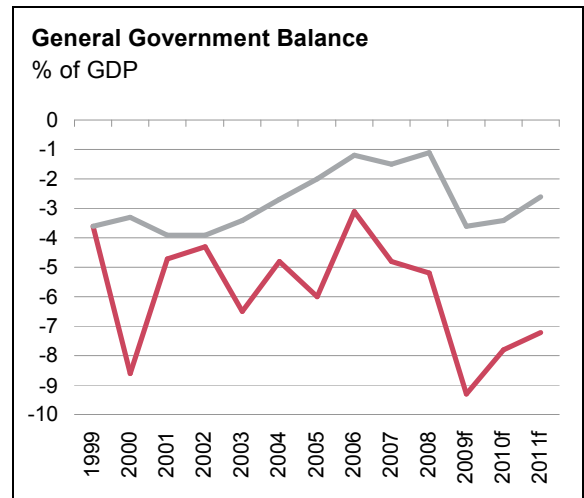
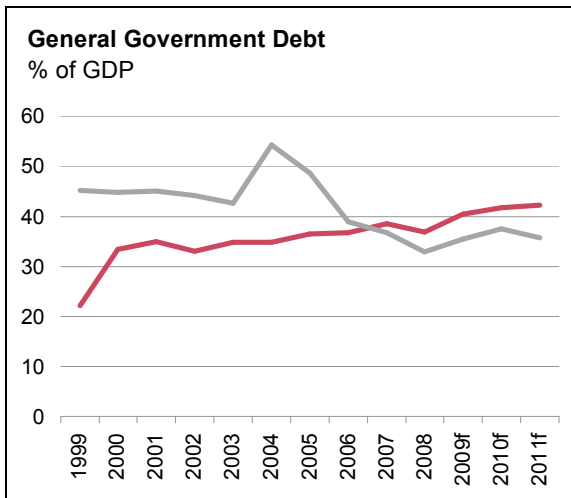
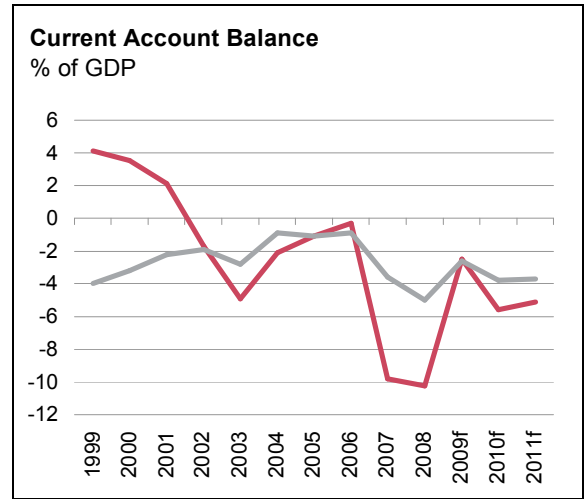
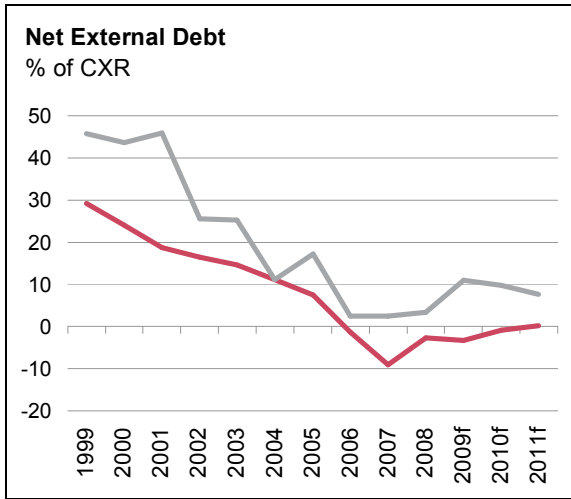
Rating Rationale

- Vietnam's external financial position has remained stronger than the medians for the 'BB' peer group (sovereigns rated 'BB+', 'BB' or 'BB-') despite heightened risks to the balance of payments (BOP), high inflation and depreciation of the Vietnamese dong (VND) in H207-H108. The government took policy measures to mitigate the negative impact of these risks on Vietnam's external finances, while maintaining the country's foreign-exchange accumulation and its net external credit position. The BOP risk has been fading, while the inflation risk and VND depreciation pressure have been mitigated. The government's external debt service is one of the lowest among the 'BB' peer group, as most of its external debt is long-term concessional.
- Despite its measures being reactive rather than pre-emptive, the government demonstrated its capacity to respond to macroeconomic issues. To address the issues of high inflation, the State Bank of Vietnam (SBV) tightened its monetary policy, while the government accommodated this by lowering its economic growth target. To address the issues of a widened trade deficit and heightened risk of VND depreciation, the SBV enhanced the VND's flexibility against foreign currencies by devaluing the VND and broadening its daily trading band.
- Vietnam's public finances have been undermined by structural issues: a low fiscal-revenue base and a reliance on volatile oil-related revenue. Owing to this, the general government fiscal balance has been in deficit structurally in spite of the high-single-digit economic growth over the last two decades. Fitch Ratings expects Vietnam's fiscal deficit to widen even as the economy recovers in H209 and into 2010. The general government debt relative to GDP has been rising steadily, comparing less favourably over time with the 'BB' median.
- In reacting to the current economic slowdown, the government has adopted an expansionary fiscal policy by introducing a sizable fiscal stimulus package. In GDP terms, Fitch expects the general government fiscal deficit to widen substantially in 2009-2011, mainly due to a contraction in fiscal revenue on the back of tax breaks, slower economic growth and a drop in oil prices. Fitch expects current fiscal expenditure will increase, due mainly to the interest subsidy on loans. However, the agency expects the increase in capital expenditure will be limited, as the government has been cautious in managing its fiscal financing costs.

Key Rating Drivers

- The structural fiscal deficit and its issues are weaknesses of Vietnam's sovereign creditworthiness, as is the government's inclination to finance its fiscal deficit with domestic debt on commercial terms more than with external debt on concessional terms. In addition, the government's domestic financing flexibility would reduce as general government domestic debt rises, which could further undermine Vietnam's sovereign creditworthiness.
- The government's policies and their flexibility are crucial to address economic issues. Policies usually require time to take effect; therefore, a pre-emptive measure is preferred to a reactive one. In this respect, the government's growth-oriented policy has constrained other government departments from implementing their measures, such as those taken by the SBV in 2008 to address macroeconomic issues like high inflation, trade-deficit widening and VND depreciation.

Peer Comparison



— Vietnam

— Medians

Peer Group

Rating	Country
BB	Armenia
	Costa Rica
	Indonesia
	Philippines
BB-	Vietnam
	Gabonese Republic
	Kingdom of Lesotho
	Nigeria
	Serbia
	Turkey
B+	Uruguay
	Cape Verde
	Georgia
	Ghana
	Kenya
	Papua New Guinea
	Sri Lanka
Venezuela	

Rating History

Date	Long-Term Foreign Currency	Long-Term Local Currency
30 Jun 09	BB-	BB-
12 Jun 02	BB-	BB

Rating Factors

Summary: Strengths and Weaknesses

Rating factor	Macroeconomic	Public finances	External finances	Structural issues
Status	Neutral	Weakness	Strength	Weakness
Trend	Stable	Stable	Stable	Stable

Note: Relative to 'BB' category
Source: Fitch

Strengths

- Vietnam’s external financial position has been stronger relative to the ‘BB’ peer group medians. Its gross external debt (GXD) has been declining relative to GDP and current external receipts (CXR). As financed by the net FDI inflows, the country’s foreign-exchange reserve accumulation continued in 2008 despite a sizable current account deficit. Vietnam has been a net external creditor since 2006 and Fitch forecasts this to continue in 2009-2011.
- Short-term debt accounts for less than 10% of GXD, while the public sector accounts for the majority of the GXD. In addition, most of the public-sector external debt is long-term concessional general government debt. As a result, the external debt service and external interest service in CXR terms are stronger than the ‘BB’ medians.
- The economic renovation policy (“doi moi”) was introduced in 1986 and has since led the economy to grow at a high-single-digit rate (annual average). Inflation remained below double digits until 2008 and the unemployment rate has remained below 7%. As an important source of growth, investment promotion has been the government’s main economic policy. In addition, political stability is a key factor in attracting foreign investments.

Weaknesses

- The structural issues in public finances are a weakness of Vietnam’s sovereign creditworthiness. A low revenue base and a reliance on volatile oil-related revenue are the main structural fiscal issues, which are accentuated by an economic slowdown and a downward oil-price cycle. As a result, the general government fiscal balance has been in deficit despite high-single-digit growth (annual average) over the last two decades.
- Government policy has been growth-oriented, reducing flexibility in monetary and fiscal policies in addressing macroeconomic issues. In addition, the SBV has limited autonomy to take pre-emptive measures in response to economic challenges, such as accelerating inflation.
- Vietnam’s banking system is weak and vulnerable to potential systemic stress. Loan growth has been at double digits for a decade and Fitch believes there are problems with asset quality in the banking system. Although a substantial heightening risk of VND depreciation is not Fitch’s base-case scenario, this could be a concern as the country’s economy is reasonably dollarised.

Local Currency Rating

Vietnam’s public finances are weak due mainly to a structural fiscal deficit and government’s inclination to borrow domestically on commercial terms more than externally on concessional terms. General government debt has been rising, reducing financing ability. All this has undermined Vietnam’s sovereign creditworthiness in local-currency terms. As a result, the country’s Local-Currency Issuer Default Rating (IDR) is the same as its Foreign-Currency IDR.

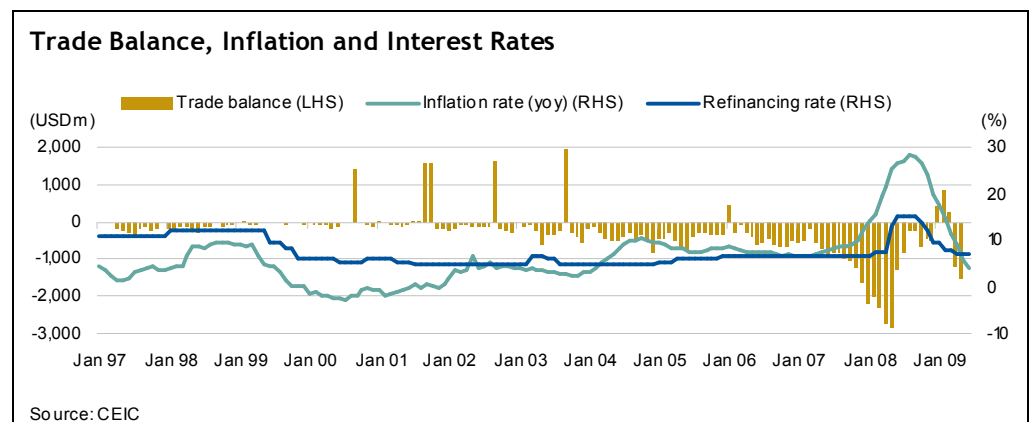
Country Ceiling

Vietnam’s financial system is not well integrated with those of other economies. Its economy is reasonably dollarised, indicating a lack of confidence in the convertible value of the VND. Its Country Ceiling is the same as its Foreign-Currency IDR.

Outlook and Key Issues

Inflation Decelerates Amid Reactive Policy Responses

The inflation rate accelerated sharply to 28% yoy in August 2008 from 6.5% in January 2007, mainly driven by food and commodity prices accompanied by an over-heating economy and a high domestic loan growth. Investment is one of the key drivers supporting economic growth. Meanwhile, the VND depreciated by 2.4% to VND16,500 per USD. The trade deficit widened significantly, to USD2.9bn in May 2008 from below USD1bn (monthly average) before September 2007. In reacting to an overheating economy, the SBV tightened its monetary policy during February-October 2008 by raising policy interest rates and increasing the reserve requirement.¹ The government accommodated this by revising its economic growth target to 7% from 8.5%-9% in early May, with the National Assembly's approval. On 19 May, the SBV raised the refinancing rate (upper bound of the policy interest rate band) sharply, by 550bp to 13%, and the discount rate (lower bound) by 500bp to 11%. The prime interest rate or base rate, a reference rate for lending activities, was also raised sharply, by 325bp to 12%. These rate hikes were the largest in Vietnam's history. The SBV began to loosen its monetary policy in October 2008 amid global financial turmoil and tightness of domestic liquidity, while the inflation rate was still high at 27% yoy.



The depreciation pressure on VND increased in 2008 amid accelerating inflation and current-account deterioration. In addition to its exchange rate management on a daily basis, the SBV substantially devalued the VND twice (2% in June and 3% in December) in 2008. The SBV also widened its daily trading band four times to ±5% in March 2009 from ±0.75% before March 2008 (after widening to ±3% in November 2008, ±2% in June 2008 and ±1% in March 2008). The depreciation pressure on VND has been reducing.

On a year-on-year basis, loan growth decelerated to 25% at end-2008 from 54% at end-2007. Fitch expects loan growth will continue to decelerate in 2009 and below its 10-year annual average of 34%, due to an expected substantial economic slowdown of 4.5%. Loan growth was 15%, when compared with end-2008, in May 2009, partly led by the interest subsidy on loans as part of the fiscal stimulus package (see *Cyclical Economic Weakening Accentuates Structural Fiscal Issues* below). In H109, the inflation rate was 10.4% yoy. Owing to an economic slowdown, slower credit growth as well as slower commodity price growth, Fitch expects Vietnam's inflation to decelerate to 7.3% in 2009 from 23.1% in 2008. On a month-to-month basis, the agency expects inflation to re-accelerate in Q409.

¹ During February-October 2008, the SBV raised the refinancing rate to 14% from 7.5%, discount rate to 12% from 6%, prime interest rate to 13% from 8.75%.

BOP Risk Fading Away

During September 2007-June 2008, Vietnam's trade deficit widened to above USD1bn (1% of GDP) per month, due mainly to sharper import growth, driven by higher food and commodity prices and a higher net FDI inflow. The monetary tightening, slower economic growth and a downward commodity price cycle helped to alleviate the pressure on the widening trade deficit. In H208, the monthly trade deficit dropped below USD1bn. On an annual basis, the country's trade deficit shrank to 13.6% of GDP in 2008 from 14.6% in 2007. The current account deficit widened slightly, to 10.2% of GDP from 9.8%, due mainly to a substantial widening of the services account deficit to 2.6% from 1.3%.

Net capital inflows also shrank substantially, to USD9.2bn in 2008 from USD17.5bn in 2007, mainly due to a significant reduction of net capital inflows for portfolio equity investment to USD0.1bn from USD6.2bn. In addition, there was a net capital outflow in other investment assets, partly due to a heightened risk of VND depreciation. However, net capital inflows for FDI went up to USD7.8bn in 2008 from USD6.6bn in 2007. Moreover, net capital inflows for short-term loans also increased sharply, to USD1.9bn from USD79m, as Vietnamese resident entities relied more on external financing sources than domestic ones amid the tighter domestic credit conditions. As a result, the change of reserves was minimal. Vietnam's international reserves (including gold) stabilised at USD24.2bn at end-2008, compared with USD23.7bn at end-2007.

External Finances: Sources and Uses

(USDm)	2008	2009 ^f	2010 ^f	2011 ^f
Uses	10,751	3,798	7,628	8,055
Current account balance (- = surplus)	9,237	2,430	5,993	6,245
MLT amortisation	1,514	1,369	1,635	1,810
Sovereign	747	524	631	666
Non-sovereign	767	845	1,004	1,144
Sources	10,751	3,798	7,628	8,055
Gross MLT borrowing	2,477	2,219	3,485	3,660
Sovereign	1,534	1,450	1,450	1,450
Non-sovereign	943	769	2,035	2,210
Net FDI	7,750	3,700	4,700	5,200
Net lending abroad	-1,536	-1,300	-1,000	-1,000
Net portfolio equity	110	500	800	1,000
Short-term debt, net	1,888	150	150	150
Capital account, net	0	0	0	0
Net E&O	-100	0	0	0
Change in fx reserves (- = increase)	162	-1,470	-507	-955

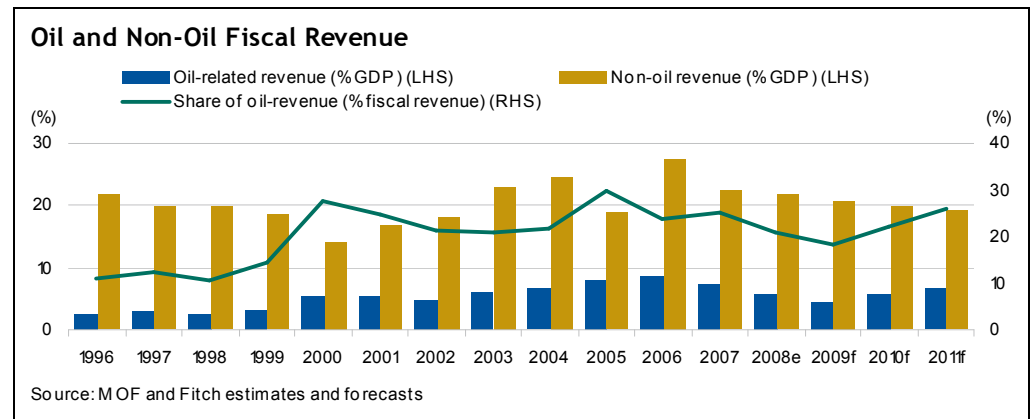
Source: Fitch

Fitch forecasts Vietnam's trade deficit will narrow substantially in 2009, due mainly to an expected substantial domestic economic slowdown and an expected reduction in net FDI on the back of global recession. In addition, private remittances from abroad will contract due to global recession. As a result, Fitch forecasts the current account deficit will narrow significantly, to 2.5% of GDP in 2009. The agency also forecasts Vietnamese resident entities will rely more on domestic financing sources amid the more favourable domestic credit conditions. Despite an expected increase in reserves, Fitch forecasts the foreign-exchange reserves to stabilise at USD24bn at end-2009, due mainly to a drawdown of government deposits for fiscal use at the SBV. The agency forecasts the country's foreign-exchange reserves to stabilise in 2010-2011.

Cyclical Economic Weakening Accentuates Structural Fiscal Issues

The structural issues in public finances are a weakness of Vietnam's sovereign creditworthiness. The fiscal-revenue base is lower than that of expenditure, and the agency expects this to deteriorate as the government is inclined to enhance the country's competitiveness in the region by reducing tax rates and providing tax

incentives. In addition, the fiscal revenue is relatively dependent on volatile oil-related revenue, accounting for between one-tenth and one-third of total fiscal revenue. These issues have been underscored during the current domestic economic slowdown and the downward oil-price cycle.



To support economic growth, the government introduced a credit guarantee programme of VND17trn (1% of GDP) for small-and-medium sized enterprises (SMEs) in May 2009. At the same time, the government expanded its fiscal stimulus package to VND143trn (8.6% of GDP or USD8.3bn) from a similar package of VND103trn (USD6bn) announced earlier. The government also proposed widening the budget deficit to 8% of GDP (government definition: excluding the off-budget investment and net lending, but including fiscal balance brought forward and debt principle payment) from 4.8%.

Fiscal Stimulus Package: Highlights

(VNDtrn)

Total package size	160.0
Infrastructure and development projects	53.6
Postponement of basic construction in investment downpayment for 2009	3.4
Postponement of planned investments from 2008 to 2009	30.2
Transport and irrigations projects, hospital and student hostels, etc.	20.0
Tax reduction and waiver	28.0
Interest subsidy for loans	17.0
Credit guarantee for SMEs	17.0
Brought forward expenditure	37.2
Expenditure to complete high priority projects	26.7
Measure to reduce the poverty rate in 61 poorest districts	1.5
Others	9.0
Others	7.2

Source: Ministry of Finance

Since the introduction of the first fiscal package, the government has been cautious about managing its costs of financing and has carried out some unsuccessful bond sales.² In Fitch's view, domestic financing options in Vietnam are limited and costly, especially in local-currency terms, as the local capital market is not sizable. Nevertheless, the current increase in USD domestic debt will reduce the interest service burden on domestic debt in the short term,³ but it exposes government finances to greater exchange rate risk over the medium term.

² Due mainly to its reluctance to pay a market-acceptable coupon rate, the government only managed to sell VND100m bonds in VND terms out of VND1.5trn in February 2009 and failed to sell bonds of VND2trn in full in May. On 4 and 18 June, the government failed to sell VND2trn local-currency bonds. For the issuance of domestic USD-denominated bonds, the government managed to sell 77% of USD300m in March.

³ After it issued the USD bond of USD230m in March 2009, the government recently approved to issue USD bond of USD1bn domestically.

Fitch notes that the fiscal stimulus spending, especially the public infrastructure investment, will mainly be financed by issuance of government bonds. Based on an expectation of limited increase in investment spending, the agency expects a marginal impact from public investment on Vietnam's general government expenditure in 2009. However, the impact of the real economic sector on fiscal revenue will be more significant. Together with the partial effects of tax reduction and waiver in the fiscal stimulus package, reduction of corporate tax rate to 25% from 28%, and lower oil prices, Fitch expects the fiscal revenue to fall to 25.4% of GDP from 27.6%. As a result, the agency expects the general government fiscal deficit will widen substantially in 2009, to 9.3% of GDP (Fitch definition: including off-budget investment, net lending and fiscal balance brought forward) from 5.2% in 2008. The agency expects the government to extend its expansionary fiscal policy in 2010 and forecasts a fiscal deficit of 7.8% of GDP.

Public Finances: Sources and Uses

(% GDP)	2008	2009 ^f	2010 ^f	2011 ^f
Uses	7.6	11.4	9.7	8.8
Budget balance (- = surplus)	5.2	9.3	7.8	7.2
O/w fiscal balance b/f (- = surplus)	0.3	0.7	0.5	0.5
Amortisation (by place of issue)	2.4	2.1	1.9	1.6
Domestic	1.9	1.7	1.5	1.3
Foreign	0.5	0.4	0.4	0.3
Sources	7.6	11.4	9.7	8.8
Gross borrowing (by place of issue)	7.6	11.4	9.7	8.8
Domestic	6.0	8.6	7.2	7.0
Foreign	1.6	1.0	1.0	0.9
Privatisation	0.0	0.0	0.0	0.0
Others (government deposit)	0.0	1.8	1.5	0.9

Source: Fitch

Forecast Summary

	2005	2006	2007	2008	2009 ^f	2010 ^f	2011 ^f
Macroeconomic indicators and policy							
Real GDP growth (%)	8.4	8.2	8.5	6.2	4.5	5.7	6.0
Consumer prices (annual average % change)	8.3	7.5	8.3	23.1	7.3	8.0	9.0
Short-term interest rate (%) ^a	5.9	6.5	6.5	11.5	7.1	6.6	6.0
General government balance (% of GDP)	-5.6	-1.5	-5.3	-4.9	-9.3	-7.8	-7.2
General government debt (% of GDP)	36.5	36.8	38.6	36.9	40.4	41.7	42.3
VND per USD (annual average)	15,858.9	15,994.3	16,105.1	16,302.3	17194.7	17544.9	17766.7
Real effective exchange rate (2000 = 100)	99.8	96.8	100.5	121.9	125.7	130.5	136.0
External finance							
Current account balance (USDm)	-560.2	-163.8	-6,992.1	-9,237.0	-2429.7	-5993.3	-6244.6
Current account balance (% of GDP)	-1.1	-0.3	-9.8	-10.2	-2.5	-5.6	-5.1
Current account balance plus net FDI (% of GDP)	2.5	3.5	-0.6	-1.6	1.3	-1.2	-0.8
Net external debt (USDm)	2,987.5	-666.9	-5,657.2	-3,346.0	-2285.3	-592.0	152.6
Net external debt (% of GDP)	5.6	-1.1	-8.0	-3.7	-2.4	-0.5	0.1
Net external debt (% of CXR)	7.4	-1.3	-9.1	-4.3	-3.3	-0.8	0.2
Official international reserves including gold (USDm)	9,216.5	13,591.0	23,747.7	24,167.7	24341.0	23847.7	24303.1
Official international reserves (months of CXP cover)	2.7	3.3	4.1	3.3	4.1	3.6	3.3
External interest service (% of CXR)	0.8	1.2	1.0	1.2	1.4	1.4	1.3
Gross external financing requirement (% int. reserves)	37.7	26.8	68.4	45.3	15.7	31.3	33.8
Memo: Global forecast summary							
Real GDP growth (%)							
US	2.9	2.8	2.0	1.1	-3.1	1.3	1.7
Japan	1.9	2.1	2.3	-0.7	-6.9	0.9	1.5
Euro area	1.8	3.0	2.7	0.6	-4.6	-0.3	1.9
World	3.3	3.8	3.6	1.7	-3.3	1.4	2.5
Commodities							
Oil (USD/barrel)	54	65	73	97	55	65	70

^a State Bank of Vietnam's refinancing rate (annual average)

Source: Fitch

Comparative Analysis: Macroeconomic Performance and Policies

Vietnam

	2008						
	Nigeria 'BB-'	Turkey 'BB-'	Uruguay 'BB-'	Vietnam 'BB-'	Sri Lanka 'B+'	'BB' median	'B' median
Real GDP (5yr average % change)	6.4	6.1	6.7	7.8	6.4	6.0	6.4
Volatility of GDP (10yr rolling SD)	5.1	5.0	5.6	1.1	2.6	3.1	2.9
Consumer prices (5yr average)	11.6	9.5	7.8	11.0	13.5	7.9	10.6
Volatility of CPI (10yr rolling SD)	4.8	23.3	4.4	6.8	5.5	3.7	5.4
Years since double-digit inflation	0	0	5.0	0	0	n.a.	n.a.
Unemployment rate	n.a.	12.0	8.2	4.7	5.6	7.5	8.4
Type of exchange rate regime	Managed floating	Independently floating	Managed floating	Conventional peg	Conventional peg	n.a.	n.a.
Dollarisation ratio	10.6	32.2	80.7	23.9	15.1	51.2	36.7
REER volatility (10yr rolling SD)	18.3	8.5	10.2	8.9	7.1	8.9	7.7

Source: IMF and Fitch

Strengths

- Since the economic renovation policy (doi moi) was introduced in 1986, Vietnam's economy has been experiencing sustained growth. The annual average growth rate was 7.5% for the last two decades. Similar to other developing countries, Vietnam's economic development has also been industrialising. The share of agricultural production in GDP fell to 18% in 2008 from 24% in 1998, while manufacturing output increased to 25% from 18%. The unemployment rate has remained below 7% amid the sustained economic growth, which is one of the crucial factors for social stability.

Weaknesses

- Vietnam's macroeconomic policy is growth-oriented and the central government sets a target of economic growth, which other government departments implement policies to promote and accommodate this. This model could constrain policy response to address economic issues when there are imbalances, either domestically or externally. The over-heating issues in 2008 underscored this weakness. The government lowered the country's economic growth target and the SBV then reacted by tightening its monetary policy. In other words, a growth target could be a constraint for the SBV to conduct appropriate and pre-emptive monetary policy.
- The conventional pegged exchange rate regime of the VND against the USD is another constraint to correct external imbalances between Vietnam and the rest of the world. A substantial exchange-rate adjustment usually requires government's policy instead of market principle, which was evident in a series of exchange rate policy adjustments (including currency devaluation and daily-trading-band widening) implemented by the SBV in 2008-2009.
- Despite its declining ratio since its peak at 42% in 2001, dollarisation prevails in Vietnam. As a result, banks' balance sheets are exposed to VND depreciation risk, especially when there is a large-scale depreciation. Foreign-currency loans, mainly related to trade activities, have remained stable at around 20% of total loans and the loan/deposit ratio in foreign-currency terms climbed sharply, to 81% in 2008 from 49% in 2002.

Commentary

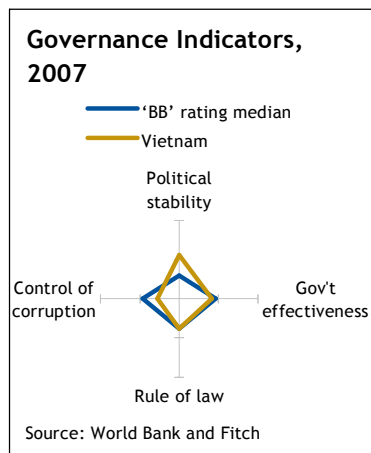
Vietnam's conventional pegged exchange rate regime is one of the key factors for BOP risk, as this regime constrains the market from correcting external imbalances. This issue could lead to another round of BOP crisis, which is a potential threat to the country's external financial position.

Comparative Analysis: Structural Features

Vietnam

	2008						
	Nigeria 'BB-'	Turkey 'BB-'	Uruguay 'BB-'	Vietnam 'BB-'	Sri Lanka 'B+'	'BB' median	'B' median
GNI per capita PPP (USD, latest)	1,770	12,350	11,040	2,550	4,210	6,440	2,940
GDP per capita (USD, mkt exchange rates)	1,343	10,095	9,232	1,041	2,029	4,527	1,857
Human development index (percentile, latest)	11.6	53.5	74.5	40.8	44.1	50.2	35.4
Ease of doing business (percentile, latest)	39.6	68.4	45.2	49.2	43.6	47.8	31.4
Trade openness (CXR and CXP % GDP)	45.8	28.6	35.0	90.7	37.8	47.6	n.a.
Gross domestic savings (% GDP)	22.1	16.5	15.7	26.6	17.8	19.1	10.7
Gross national savings (% GNP)	31.7	16.7	16.4	31.6	23.5	21.6	16.2
Gross domestic investment (% GDP)	8.9	22.3	19.8	41.1	31.6	24.1	26.5
Private credit (% GDP)	33.0	33.8	27.6	90.6	29.1	33.4	26.4
BSR indicators	D3	C3	E1	D2	E1	n.a.	n.a.
Bank system CAR	21.9	17.7	16.7	9.7	13.1	n.a.	n.a.
Foreign bank ownership (% assets)	11.8	14.0	44.0	25.0	12.0	n.a.	n.a.
Public bank ownership (% assets)	0.0	28.0	47.3	48.0	46.0	17.3	15.3
Default record (year cured)	None	1982	2003	1998	None	n.a.	n.a.

Source: Fitch and World Bank



Strengths

- Vietnam has long been ruled by one political party and it has been more politically stable than the 'BB' peer median, as indicated by the respective governance indicator (see chart). Together with a long period of sustained economic development, social stability has been maintained. All these are Vietnam's strengths from a sovereign rating perspective.

Weaknesses

- Vietnam's banking system indicator (BSI) was revised to 'D', representing its banking system as being of "low" quality, from 'E' as Fitch has improved the transparency of the translation of bank Individual Ratings to the BSI by changing the rounding methodology of the System Average Individual Rating.⁴ Vietnam's banking system's vulnerability risk to potential systemic stress is "moderate".
- A negative or low positive real interest rate, from a borrower's perspective, is one of the main factors leading to rapid credit expansion, which has been a potential threat to banks' risk management. Loans have been growing at double-digits; the annual average loan growth was 34% over the last 10 years. Private credit has climbed to over 90% of GDP from below 20% 10 years ago.
- Although high public ownership in banks helps maintain public confidence in Vietnam's banking system, it could hinder banking and financial development. The equitisation (partial privatisation) of state-owned enterprises (including state-owned commercial banks) has been slow due to unfavourable market conditions, and Fitch expects there will be little progress on this in 2009-2011.

Commentary

Vietnam's trade openness is higher than the 'BB' median and is one of the highest in the peer group, indicating its economy is highly exposed to trade activities and vulnerable to external shocks. This has been underscored by the current global economic recession.

Although Vietnam's banking system is weak and vulnerable to systemic stress, Vietnamese banks' exposure of external positions to depreciation risk of VND is limited, as its net external credit position is about 4% of GDP. In addition, external bank loans have exceeded external deposits since 2007.⁵

⁴ For details, please refer to Fitch's *Bank Systemic Risk Report*, May 2009

⁵ For details, please refer to BIS's provisional international banking statistics, fourth quarter 2008

Comparative Analysis: External Finances

Vietnam

	2008					Last 10 years	
	Nigeria 'BB-'	Turkey 'BB-'	Uruguay 'BB-'	Vietnam 'BB-'	Sri Lanka 'B+'	'BB' median	'B' median
GXD (% CXR)	14.2	164.3	192.0	36.5	130.6	111.5	112.8
GXD (% GDP)	8.1	42.0	61.2	31.2	43.9	43.5	54.4
NXD (% CXR)	-39.8	77.1	-25.7	-2.7	101.1	24.5	35.9
NXD (% GDP)	-22.7	19.7	-8.2	-2.3	34.0	10.8	21.1
GSXD (% GXD)	21.7	38.1	63.1	77.1	82.5	48.3	64.8
NSXD (% CXR)	-41.7	22.6	53.2	-3.0	93.8	12.6	32.7
NSXD (% GDP)	-23.8	5.8	17.0	-2.6	31.6	4.9	17.0
SNFA (USDm)	n.a.	-41,753.8	-4,284.9	2,357.7	-12,847.4	-2323.7	-737.3
SNFA (% GDP)	n.a.	-5.8	-14.3	2.6	-31.6	-5.6	-13.0
Ext. debt service ratio (% CXR)	2.2	29.1	26.1	3.2	10.7	17.3	11.7
Ext. interest service ratio (% CXR)	1.1	7.2	10.2	1.2	3.5	5.4	3.5
Liquidity ratio (latest)	584.7	93.9	99.9	1,075.2	99.4	115.3	139.2
Current account balance (% GDP)	20.1	-5.8	-4.6	-10.2	-8.4	-2.7	-4.0
CAB plus net FDI (% GDP)	22.9	-3.6	1.2	-1.6	-8.0	1.4	-0.2
Commodity dependence (% CXR, latest)	82.1	43.8	46.1	40.0	18.9	25.9	17.2
Sovereign net FX debt (% GDP)	-22.9	2.3	16.9	-2.6	36.7	n.a.	n.a.

Source: Fitch

Strengths

- In GDP and CXR terms, Vietnam's GXD is lower than the 'BB' medians. Short-term debt accounts for 7.4% of GXD, while the public sector accounts for 77% of GXD. Also, most public-sector debt is long-term concessional general government debt (66% of GXD), with an average maturity of 29 years and an interest rate of 1.2%. Owing to this, the external debt service and interest service are among the lowest in the 'BB' peer group.
- The net FDI inflow has helped to finance the current account deficits, which is important to mitigate BOP risk as net inward FDI is a more stable non-debt source of capital flows. In 2008, the net FDI inflow (8.5% of GDP) largely offset the negative effects of a sizable current deficit (10.2%) on Vietnam's external financial position. The CAB plus net FDI has not fallen below -2% of GDP since 1991.
- There was no reduction in Vietnam's foreign-exchange reserves in 2008 despite heightened risks to the BOP, high inflation and VND depreciation. The country's net external credit position has remained stronger than the 'BB' median. Both the government and banks are net external creditors. Fitch expects these to remain better than the 'BB' medians due to an expected stabilisation in the country's foreign-exchange reserves.

Weaknesses

- Vietnam's commodity dependence is higher than the 'BB' median. The country exports crude oil (17% of total merchandise exports) and imports petroleum products (13% of imports) as it has limited domestic refinery facilities. Even so, it is a net exporter of oil-related goods. As a manufacturing exporter, Vietnam is reasonably dependent on raw materials. Spare parts and raw materials are the major imported items for Vietnam, while textile and garments, footwear, computers and electronic products are the major exported goods.

Commentary

Although net FDI inflows have helped to offset the negative impact of current-account deterioration, a more flexible exchange rate regime and a more responsive government policy framework could help to mitigate the volatility of Vietnam's BOP components as well as BOP risks.

Comparative Analysis: Public Finances

Vietnam

	2008					Last 10 years	
	Nigeria 'BB-'	Turkey 'BB-'	Uruguay 'BB-'	Vietnam 'BB-'	Sri Lanka 'B+'	'BB' median	'B' median
Budget balance (% GDP)	2.9	-2.9	-1.1	-5.2	-6.4	-2.3	-2.2
Primary balance (% GDP)	6.7	1.9	1.8	-4.2	-1.5	0.9	1.0
Revenues and grants (% GDP)	28.8	21.0	25.6	27.6	16.6	23.8	29.6
Volatility of revenues/GDP ratio	15.1	8.1	3.0	19.4	5.1	6.5	10.1
Interest payments (% revenue)	7.3	24.3	11.1	3.8	29.4	12.0	8.6
Debt (% revenue)	38.3	197.2	204.0	133.6	473.8	190.5	185.9
Debt (% GDP)	11.0	41.3	52.1	36.9	78.8	41.7	50.6
Net debt (% GDP)	-10.7	37.9	37.9	28.1	0.0	34.5	50.0
FC debt (% total debt)	23.1	30.0	62.0	65.2	52.5	66.3	70.6
CG debt maturities (% GDP)	2.5	12.0	2.4	2.4	16.9	5.8	5.4
Average duration of CG debt (years)	0.0	3.4	n.a.	n.a.	0.0	3.0	8.5

Source: Fitch

Strengths

- The government's fiscal financing costs, such as interest payments in revenue terms, are lower than the 'BB' medians. However, Fitch expects these to become less favourable as the agency forecasts Vietnam's domestic government debt in GDP terms to increase and surpass its external debt, due mainly to the government's inclination to rely on commercial domestic-debt-financing sources more than the concessional external-debt sources.
- In addition to debt, the government can also access non-debt sources to finance its deficit. A readily available source is government deposits of about USD7bn (equivalent to 7% of GDP). A drawdown of its portion at the SBV will reduce Vietnam's foreign-exchange reserves. Proceeds from equitising state-owned enterprises could also be another source; but it is difficult to assess.

Weaknesses

- In GDP terms, the general government fiscal balance has been in structural deficit despite the annual average economic growth rate being in high single digits over the last two decades. Low fiscal revenue is an issue and Fitch expects this will deteriorate, as the agency believes it is a government policy to enhance the country's competitiveness in the region by reducing tax rates and implementing tax incentives. Since 1 January 2009, the government has reduced the corporate income tax rate to 25% from 28%.
- Vietnam's revenue volatility in GDP terms is higher than the 'BB' median, due mainly to a structural fiscal issue of reliance on volatile oil-related revenue. The share of oil-related fiscal revenue has been between one-tenth and one-third of total fiscal revenue since 1996. Oil-related fiscal revenue may not always act as a buffer to counteract a reduction in non-oil revenue, as oil prices usually fluctuate in step with economic cycles.
- In addition, general government debt relative to GDP has been rising steadily since 2002, contradicting the declining trend of the 'BB' median, and has been larger than the median since 2007. Government domestic debt also shows a similar pattern relative to the 'BB' median.

Fiscal Accounts Summary

(% of GDP)	2006	2007	2008	2009 ^f	2010 ^f	2011 ^f
General government						
Revenue	36.0	30.0	27.6	25.4	25.3	26.0
Expenditure	39.1	34.8	32.8	34.7	33.1	33.2
O/w interest payments	0.8	1.0	1.0	1.2	1.2	1.2
Primary balance	-2.3	-3.8	-4.2	-8.1	-6.6	-6.0
Overall balance	-3.1	-4.8	-5.2	-9.3	-7.8	-7.2
General government debt	36.8	38.6	36.9	40.4	41.7	42.3
% of general government revenue	102.1	128.8	133.6	159.2	164.4	162.4
General government deposits	6.6	7.8	7.3	5.5	4.0	3.1
Net general government debt	30.0	30.8	28.1	34.4	37.4	39.0
Central government						
Revenue	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
O/w grants	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Expenditure and net lending	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
O/w current expenditure and transfers	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
- Interest	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
O/w capital expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Current balance	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Primary balance	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Overall balance	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Central government debt	35.8	37.7	36.0	39.5	40.7	41.4
% of central government revenues	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Central government debt (VNDtrn)	349.1	431.2	531.4	654.3	770.3	904.5
By residency of holder						
Domestic	112.1	147.9	201.8	308.2	407.4	522.1
Foreign	237.0	283.3	329.6	346.1	363.0	382.4
By place of issue						
Domestic	118.0	155.6	212.5	324.5	428.8	549.6
Foreign	231.1	275.6	319.0	329.9	341.5	354.9
By currency denomination						
Local currency	118.0	155.6	212.5	301.1	394.0	515.4
Foreign currency	231.1	275.6	319.0	353.3	376.3	389.0
In USDbn (eop exchange rate)	14.4	17.1	18.8	20.3	21.3	21.8
By maturity						
Less than 12 months (residual maturity)	34.9	34.8	41.2	53.7	98.2	133.9
Average maturity (years)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Average duration (years)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Memo						
Non-financial public-sector balance (% GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net non-financial public-sector debt (% GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Nominal GDP (VNDtrn)	974.3	1,143.7	1,477.7	1,656.6	1,890.9	2,185.8

Source: Ministry of Finance and Fitch estimates and forecasts

External Debt and Assets

(USDm)	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Gross external debt	10,018.0	12,330.0	12,649.0	12,400.0	13,350.0	14,613.1	16,673.0	19,112.0	23,071.0	28,305.0
% of GDP	34.9	39.6	38.7	35.4	33.8	32.2	31.5	31.4	32.5	31.2
% of CXR	65.2	64.2	65.2	57.0	51.8	43.4	41.3	38.5	37.1	36.5
By maturity										
Medium- and long-term	9,811.0	12,045.0	12,489.0	12,238.0	13,192.0	14,509.1	16,523.0	18,932.0	22,865.0	26,211.0
Short-term	207.0	285.0	160.0	162.0	158.0	104.0	150.0	180.0	206.0	2,094.0
% of total debt	2.1	2.3	1.3	1.3	1.2	0.7	0.9	0.9	0.9	7.4
By debtor										
Monetary authorities	355.0	316.0	352.0	380.0	326.0	268.8	215.0	189.0	170.0	132.4
General government	6,590.0	9,277.0	9,860.0	9,802.0	10,916.0	12,263.1	13,773.0	15,613.0	19,968.0	21,810.0
O/w central government	875.5	1,783.4	2,270.8	2,572.7	3,735.4	4,614.8	6,193.7	7,351.3	9,659.3	12,514.8
Banks	664.7	682.6	679.6	640.1	684.8	1,197.9	1,457.7	2,044.7	2,081.4	1,900.8
Other sectors	2,763.3	2,370.4	2,109.4	1,957.9	1,749.2	1,152.2	1,442.3	1,454.3	1,021.6	4,594.2
Gross external assets (non-equity)	5,537.1	7,722.1	9,016.5	8,808.3	9,578.1	10,864.8	13,685.5	19,778.9	28,728.2	30,377.0
International reserves, incl. gold	3,423.4	3,509.6	3,765.1	4,231.8	6,359.1	7,186.1	9,216.5	13,591.0	23,747.7	24,167.7
Other sovereign assets nes	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deposit money banks' foreign assets	2,113.7	4,212.5	5,251.4	4,576.5	3,218.9	3,678.7	4,469.1	6,187.9	4,980.5	6,209.3
Other sector foreign assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net external debt	4,480.9	4,607.9	3,632.5	3,591.7	3,772.0	3,748.3	2,987.5	-666.9	-5,657.2	-2,072.0
% of GDP	15.6	14.8	11.1	10.2	9.5	8.3	5.6	-1.1	-8.0	-2.3
% of CXR	29.2	24.0	18.7	16.5	14.6	11.1	7.4	-1.3	-9.1	-2.7
Net sovereign external debt	3,166.6	5,767.4	6,094.9	5,570.2	4,556.9	5,077.0	4,556.5	2,022.0	-3,779.7	-2,357.7
% of GDP	11.0	18.5	18.6	15.9	11.5	11.2	8.6	3.3	-5.3	-2.6
Net bank external debt	-1,449.0	-3,529.9	-4,571.8	-3,936.3	-2,534.1	-2,480.9	-3,011.3	-4,143.2	-2,899.1	-4,308.5
Net other external debt	2,763.3	2,370.4	2,109.4	1,957.9	1,749.2	1,152.2	1,442.3	1,454.3	1,021.6	4,594.2
Net international investment position	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
% of GDP	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Sovereign net foreign assets	-3,166.6	-5,767.4	-6,094.9	-5,570.2	-4,556.9	-5,077.0	-4,556.5	-2,022.0	3,779.7	2,357.7
% of GDP	-11.0	-18.5	-18.6	-15.9	-11.5	-11.2	-8.6	-3.3	5.3	2.6
Debt service (principal & interest)	1,491.0	1,795.0	1,208.0	1,185.0	1,462.0	2,289.8	2,468.0	2,910.0	2,927.0	2,466.0
Debt service (% of CXR)	9.7	9.3	6.2	5.5	5.7	6.8	6.1	5.9	4.7	3.2
Interest (% of CXR)	2.8	2.6	1.8	1.3	1.1	0.8	0.8	1.2	1.0	1.2
Liquidity ratio (%)	191.8	276.6	517.2	670.4	542.4	391.3	422.4	447.2	636.6	1,075.2
Net sovereign FX debt (% of GDP)	11.0	18.5	18.6	15.9	11.5	11.2	8.6	3.3	-5.3	-2.6
Memo										
Nominal GDP	28,683.7	31,172.7	32,685.1	35,064.1	39,552.5	45,427.9	52,917.4	60,915.5	71,014.8	90,643.7
Gross sovereign external debt	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Inter-company loans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: IMF, World Bank and Fitch estimates and forecasts

Debt Service Schedule on Medium- and Long-Term Debt at End-2008

(USDm)	2008	2009	2010	2011	2012	2013	2014+
Sovereign							
Official bilateral	355	256	324	354	378	393	7,279
O/w Paris Club	322	232	294	321	344	357	6,608
Multilateral	327	236	298	326	348	362	6,701
O/w IMF	38	39	39	39	15	0	0
Other	41	7	-16	-39	-40	-41	1,642
Bonds placed in foreign markets	0	0	0	0	0	0	0
Non-resident holdings of domestic debt	25	26	26	26	26	26	26
Interest	662	406	446	435	439	435	9,200
Total sovereign debt service	1,409	930	1,077	1,101	1,151	1,174	24,848
Private sector							
Amortisation	463	529	635	723	484	463	1,566
Interest	223	255	306	348	233	223	754
Total private debt service	686	784	941	1,072	717	686	2,320
Memo							
Non-sovereign public sector	451	468	546	624	624	702	1,319

Sources: Ministry of Finance, State Bank of Vietnam and Fitch

Balance of Payments

(USDm)	2006	2007	2008	2009 ^f	2010 ^f	2011 ^f
Current account balance	-163.8	-6,992.1	-9,237.0	-2,429.7	-5,993.3	-6,244.6
% of GDP	-0.3	-9.8	-10.2	-2.5	-5.6	-5.1
% of CXR	-0.3	-11.3	-11.9	-3.5	-8.2	-7.5
Trade balance	-2,775.6	-10,360.1	-12,283.0	-3,535.8	-7,357.0	-7,860.4
Exports, fob	39,826.0	48,561.0	62,906.0	56,615.4	60,012.3	69,614.3
Imports, fob	42,601.6	58,921.1	75,189.0	60,151.2	67,369.3	77,474.7
Services, net	-8.2	-894.0	-2,315.0	-1,768.5	-1,856.9	-1,905.5
Services, credit	5,100.0	6,030.0	6,300.0	5,985.0	6,284.3	6,724.1
Services, debit	5,108.2	6,924.0	8,615.0	7,753.5	8,141.2	8,629.6
Income, net	-1,429.0	-2,168.0	-1,969.0	-1,625.4	-1,779.4	-1,978.6
Income, credit	668.0	1,093.0	1,068.0	1,518.8	1,579.5	1,594.8
Income, debit	2,097.0	3,261.0	3,037.0	3,144.3	3,358.9	3,573.5
O/w: Interest payments	607.0	626.0	952.0	985.6	1,052.9	1,120.2
Current transfers, net	4,049.0	6,430.0	7,330.0	4,500.0	5,000.0	5,500.0
Memo						
Non-debt-creating inflows (net)	3,628.0	12,793.0	7,860.0	4,200.0	5,500.0	6,200.0
O/w equity FDI	2,315.0	6,550.0	7,750.0	3,700.0	4,700.0	5,200.0
O/w portfolio equity	1,313.0	6,243.0	110.0	500.0	800.0	1,000.0
O/w other	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserves (-=increase)	-4,291.6	-10,180.0	162.0	-1,470.3	-506.7	-955.4
Gross external financing requirement	2,466.8	9,293.1	10,751.0	3,798.4	7,628.2	8,054.9
Stock of international reserves, incl. gold	13,591.0	23,747.7	24,167.7	24,341.0	23,847.7	24,303.1

Sources: IMF and Fitch estimates and forecasts

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